Mr Joe Dimasi
Senior Commissioner
Independent Competition and Regulatory Commission
PO Box 161
Civic Square ACT 2601

By email icrc@act.gov.au

29 February 2023

Dear Mr Dimasi

Standing offer prices for the supply of electricity to small customers from 1 July 2024 – Response to Draft Decision

ActewAGL Retail ("ActewAGL") welcomes the opportunity to respond to the Independent Competition and Regulatory Commission's ("the Commission") Draft Decision for its investigation into standing offer prices for the supply of electricity to small customers from 1 July 2024 ("the draft decision").

ActewAGL supports the Commission's evidence-based approach to this price investigation. ActewAGL agrees with the Commission's draft decision to change the timing of its annual recalibration process and increase the retail operating cost allowance to a more sustainable level. ActewAGL also agrees with the Commission's view that the ACT's retail electricity market is more competitive today than it was 4 years ago during the last review of the standing offer methodology.

However, ActewAGL considers some further refinements to the cost stack methodology are required to ensure it balances the requirements outlined in the Terms of Reference.

ActewAGL continues to support the inclusion of interval meter data in the Energy Purchase Cost (EPC) model methodology, as it differs materially from the current input data and is expected to become a larger proportion of the total load profile. ActewAGL would request that the Commission reconsider its draft decision to move to a 23-month volume-weighted methodology for ASX future prices. ActewAGL considers it unnecessarily increases price volatility in the EPC model.

ActewAGL supports the use of a percentage margin applied to all cost categories, instead of the hybrid fixed dollar approach proposed in the draft decision. ActewAGL considers the draft decision approach does not adequately compensate retailers for the risks associated with increasing wholesale energy costs.

The attached appendix provides ActewAGL's response to key issues in the Commission's draft decision.

Should you have any questions or wish to discuss the matters raised in this submission further, please contact ActewAGL's Group Manager Business Intelligence and Transformation, Rohan Richardson on [redacted] or via email to [redacted]

Yours sincerely

[redacted]

Rachael Turner
General Manager - ActewAGL Retail

Appendix: ActewAGL's response to key issues in the Commission's draft decision

ActewAGL supports the changes proposed by the Commission to bring forward the timing of its annual price review process. Publishing the annual re-calibration of standing offer prices earlier will allow for the timely release of the annual Reference Price Determination and aid retailer compliance with jurisdictional and national regulatory obligations.

However, ActewAGL considers further minor revisions to the cost-stack methodology, as outlined below, will ensure the methodology responds to the objectives outlined in the ACT Government's Terms of Reference for this review.

Interval meter data should be included in the load shape profile

ActewAGL continues to support inclusion of interval meter data to inform the load shape profile in the Energy Purchase Cost (EPC) model. ActewAGL agrees with the Commission's view that the proportion of load from interval meter consumption is likely to accelerate going forward.[1]

It is critical that the methodology is updated now in anticipation of this change, instead of waiting until the next review of the cost stack methodology in 2027.

ActewAGL notes the Commission was able to procure the required information from Evoenergy and incorporate the data with the Net System Load Profile (NSLP) data from the Australian Energy Market Operator (AEMO).

ActewAGL's analysis confirms the Commission's conclusion that the current load profile inclusive of interval meter data increases the EPC model by approximately $1 per MWh. ActewAGL's analysis also suggests this figure will increase significantly over time and be higher by 2027.[2]

Figure 1 shows the significant difference between the load profile of interval meter data compared to the NSLP data. ActewAGL forecasts approximately 70 per cent of electricity customers in the ACT will have an interval meter by 2027. The total load profile in 2027 will more closely reflect the profile shown in the interval meter data compared to the NSLP data (as shown in Figure 1).

[1] ICRC, Draft Report: Retail electricity price investigation 2024-27, January 2024, p.36.
[2] ICRC, Draft Report: Retail electricity price investigation 2024-27, January 2024, p.36.

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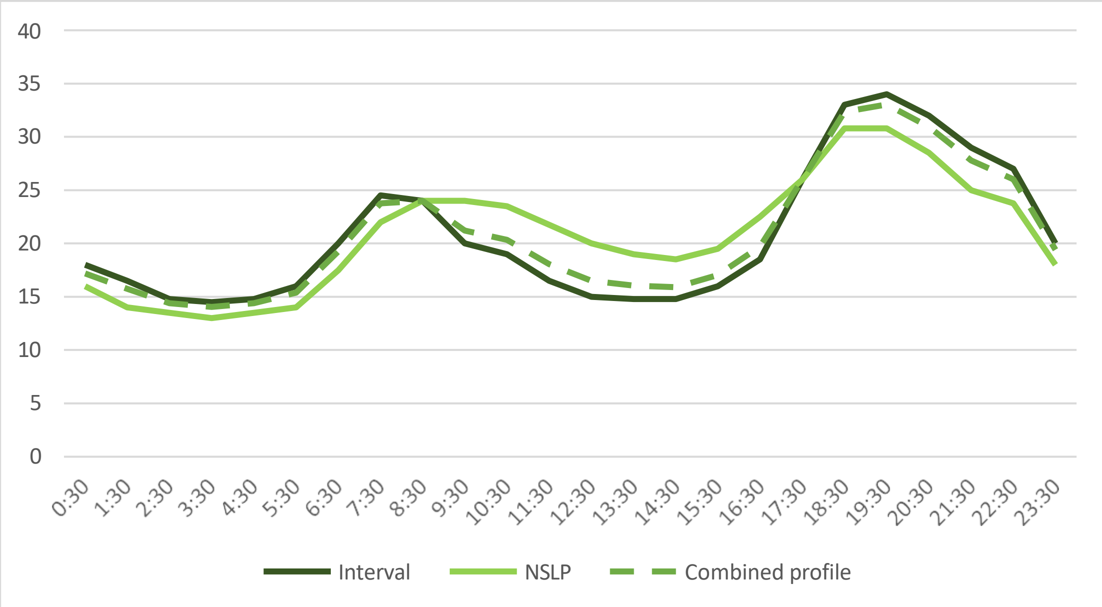
Figure 1: 2027 combined load profile with 70% interval meter penetration for small customers



ActewAGL understands the interval meter data can be easily obtained and published on a regular basis by Evoenergy. Given the material impact this issue has on the load profile, the upcoming roll out of interval meters in the ACT and the time before the Commission's next methodology review, ActewAGL considers it is critical this is addressed through the current review.

Pass through costs should be attributed to appropriate impactors

The Commission's draft decision is to re-instate a materiality threshold. While ActewAGL accepts the re-instatement of the threshold, further clarity is sought regarding how pass-through costs would be applied.

ActewAGL agrees with the Commission that energy volumes generally provide the most balanced measurement of customer segments. However, ActewAGL considers an alternate option in some circumstances would be to have costs passed through to the customer segments likely to receive the greatest level of benefit from the regulatory change event.

For example, ActewAGL considers implementation costs to comply with the AEMC's *5-minute Settlement* Rule Change should not have been recovered from mass-market and commercial and industrial (C&I) customers based on energy volumes. Using this approach disproportionately recovered costs from C&I customers when the benefits of the rule change were equally attributable to all customers regardless of volume used.

Maintaining flexibility in the methodology will ensure costs that result in better outcomes for a customer segment can be attributed directly to that customer segment.

ActewAGL recommends the Commission adopt a flexible approach and accept pass through applications that propose a different allocator if the application demonstrates the benefits can be better attributed to the customer segment/s that receive the benefit. This approach is more efficient and consistent with the Terms of Reference for this review, relevant to balancing efficiency with protection for customers.

The retail margin should be applied to the total cost stack

ActewAGL supports the approach of updating the retail margin using the expected returns methodology. However, it is noted that the proposed EBITDA margin of 5.2% is lower than the current allowance, which continues to trend downwards over time.

ActewAGL supports a sustainable retail margin that reflects the costs of retailing electricity in the ACT. While ActewAGL maintains that the current allowance is too low and does not reflect a reasonable return to an efficient retailer. ActewAGL accepts the draft decision given the current cost of living pressures facing the ACT community. ActewAGL requests that this position be re-evaluated when setting the margin in 2027.

A percentage margin appropriately captures the relationship between risk and efficient returns

ActewAGL does not support the approach of implementing half of the margin as a dollar amount and half as a percentage. Historically, the retail margin has always been applied as a percentage margin to all other cost stack categories.

ActewAGL does not agree with Frontier Economics' view that the average of a constant percentage and a constant in dollar terms approach provides a more reasonable margin for retailers. A retail margin that scales with the total value of the cost stack components produces a result that better compensates retailers for systematic risks.

The current approach of applying a percentage margin appropriately recognises the relationship between higher wholesale prices, market volatility and the risks faced by retailers.

ActewAGL agrees with the view from Frontier Economics where it states that if Wholesale Electricity Costs (WEC) were to increase, the fixed proportion of costs would decrease as energy costs tend to be more variable than other costs. However, ActewAGL considers further regard should be provided to the linkage between total costs and risk. Increasing energy costs would reduce the proportion of risk faced by the retailer, but the relationship is not linear, and increases in total cost produces other risks, including a need to maintain additional working capital.

The linkage was clearly demonstrated during the WEC volatility observed during 2022 that resulted in several retailer failures.

ActewAGL also notes the proportion of the margin that Frontier Economics proposed should be fixed, which was adopted in the draft decision, is not directly supported by the expected returns approach or the underlying cost structure of an efficient retailer.

The example developed by Frontier Economics on page 64 of its report uses movements in underlying WEC to demonstrate the benefits of its proposed approach. These examples are unlikely to eventuate and do not, in and of themselves, suggest the proposed approach to fix half of the margin is an appropriate regulatory action.

ActewAGL would request further consideration is given to how the retail margin is applied and supports retaining the current approach of applying a constant percentage. ActewAGL considers this would produce a better result for customers by adequately compensating retailers for the systematic risks of retailing in the ACT.

Volume weighted ASX futures elevate price volatility

ActewAGL notes the draft decision to move to a 23-month volume-weighted average methodology for ASX futures prices. The draft decision states that a volume-weighting approach is consistent with the approaches used by the Australian Energy Regulator (AER) and the Victorian Essential Services Commission (ESC), and that it provides a better balance of economic efficiency and social considerations.

The draft decision follows analysis by Frontier Economics which examined a range of approaches. Frontier Economics found a 40-day time-weighted approach was the most volatile while the existing 23-month time-weighted average was the least volatile. A noteworthy observation was made when comparing the 23-month and 12-month volume weighed prices. They were found to be very similar because most of the volume is traded in the twelve months to April each year.

ActewAGL's examination of the 23-month volume-weighted approach over the five prior years 2019/20 through 2023/24 reveals, on average, 50 per cent of volume is purchased in the last 6 months, with the range being between 40 per cent and 60 per cent. ActewAGL considers this approach produces additional price volatility, which is not in the best interests of customers, and therefore does not provide a better balance of economic efficiency and protection for customers.

ASX trade volumes cover wholesale hedging for all customers, not just for mass market. ActewAGL also notes that many large customers take a just-in-time approach to forward contracting. For these reasons 'late contracting' is observed in ASX trade volumes. ActewAGL considers the Commission should reconsider the appropriateness of the draft decision approach to building a mass market hedge portfolio and instead maintain the current approach.

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